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RUEHGP/AMEMBASSY SINGAPORE 5713
RUEHBK/AMEMBASSY BANGKOK 3360
RUEHKP/AMCONSUL KARACHI 2267
RUEHCG/AMCONSUL CHENNAI 8220
RUEHDE/AMCONSUL DUBAI 0137
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RUEHC/DEPT OF LABOR WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
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TAGS: EAIR EINV CE
SUBJECT: SRI LANKA: EMIRATES AIRLINES TERMINATES MANAGEMENT OF
NATIONAL CARRIER CITING EXCESSIVE INTERFERENCE

REF: 07 COLOMBO 394

¶1. (SBU) Summary and comment: Emirates Airlines announced on January 7 that it would not seek to renew its management contract with national carrier Sri Lankan Airlines, of which it owns 44 percent. Emirates' decision followed poor progress in negotiations with the government of Sri Lanka on renewal of the 1998 ten-year contract. Emirates cited the government's desire to have greater control over day-to-day management of the airline as the reason for its withdrawal. However, a major contributing factor was the government's expulsion of the Emirates-appointed Sri Lankan Airlines CEO following the airline's refusal to offload passengers and delay a flight to accommodate a last-minute request for President Rajapaksa and his entourage to be given seats from London to Colombo. Emirates told the press it is willing to sell all or part of its stake in Sri Lankan. Potential buyers will be wary, however, because return of the airline to government control portends the same kind of political interference and unprofessional management that has driven other state-owned enterprises -- including the new budget airline Mihin Air -- into debt. Emirates' pullout will be a loss for Sri Lanka, as it had the cash and the management expertise to significantly improve the national carrier's service and standards and thereby help boost tourism. End summary and comment.

¶2. (U) On January 7, Emirates Airlines announced that it does not intend to renew its ten-year management contract of Sri Lankan Airlines, which expires at the end of March. Dubai-based Emirates took over management of the unprofitable former Air Lanka when it bought a 44 percent equity stake in the flag carrier for $70 million in 1998. The Government of Sri Lanka (GSL), which owns 51 percent of the airline, will apparently resume management as a result of Emirates' departure. Emirates has stated that it is willing to sell all or part of its stake in Sri Lankan, and has valued its shares at $150 million. Under Emirates management, the airline expanded its fleet from nine to fourteen planes, more than doubled its passenger and cargo loads, and became the largest foreign carrier into India.

EMIRATES RESISTED POLITICAL INTERFERENCE

¶3. (SBU) The split comes after months of increasingly acrimonious negotiations over renewal of Emirates' ten-year management contract, punctuated by instances of government displeasure over Emirates' resistance to interference in Sri Lankan's operations. For example, last week, Sri Lankan briefly suspended provision of ground handling services to state-owned budget airline Mihin Air (reftel), which had accumulated over a million dollars in unpaid bills for the services. (Mihin Air has also run up debts for jet fuel purchases from the state-owned Ceylon Petroleum Corporation. Almost a year old, Mihin Air has steadily operated at a loss and recently stopped flying one of its two planes because it could not afford to make lease payments). Sri Lankan resumed the services without being paid after the chairman of its board interceded with Emirates management.

¶4. (SBU) In an even more high profile incident, in December 2007, Sri Lankan Airlines refused to offload thirty passengers and delay a flight in order to accommodate a last-minute request to fly President Rajapaksa and his entourage from London to Colombo. (The President, who was attending his son's graduation from the UK Royal Naval College at Dartmouth, decided to rush back to Colombo in time for the Parliamentary budget vote. The President ultimately ordered Mihin Air to send one of its two planes to pick him up and bring him back.) Citing "failure to accommodate the request of the majority shareholder," Sri Lanka hit back by revoking the resident visa of Sri Lankan CEO Peter Hill, an Emirates employee.

NO POTENTIAL BUYERS IN SIGHT; AIRLINE BARELY PROFITABLE
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¶5. (SBU) There is no early indication of a likely buyer for Emirates' stake in Sri Lankan. Qatar Airlines denied rumors that it would be interested. Sri Lankan's airline operations currently produce little profit due to the decline in tourists that are deterred by Sri Lanka's ethnic separatist conflict. Most of Sri Lankan's revenue comes from its catering and ground handling services, which operate as separate business units, serving both Sri Lankan and other carriers operating to and from Colombo. Sri Lankan and Emirates have integrated code shares, mileage programs, business class lounges, and computer and distribution systems. However, these are under separate commercial agreements between the two companies, so they will not be dissolved with the Emirates management pullout.

SRI LANKAN STAFF WORRIED

¶6. (SBU) In the wake of Emirates' departure, Sri Lankan Airlines employees, who collectively own the remaining five percent of the airline's shares, are reportedly trying to get out too. Some are seeking employment with Emirates or other reputable carriers, in the hopes of gaining both higher wages and better job security. While it managed Sri Lankan, Emirates maintained a policy against hiring staff away from the national carrier; it lifted that ban shortly before announcing its pullout, and has reportedly invited senior Sri Lankan pilots and engineers to apply for Emirates positions. Reflecting staff anxiety over the management shift, Sri Lankan Airlines unions wrote to the Ministry of Ports and Aviation and demanded to see a business plan from the government before it takes over the airline in April.

COMMENT: ANOTHER SIGN OF SRI LANKA'S
DETERIORATING INVESTMENT CLIMATE

¶7. (SBU) Emirates' pullout will be a loss for Sri Lanka, as it had the cash and the management expertise to significantly improve the national carrier's service and standards and thereby help boost tourism. Potential buyers have much to be wary of, however, because return of the airline to government control portends the same kind of political interference and unprofessional management that has

driven other state-owned enterprises -- including Mihin Air -- into debt. Moreover, with Sri Lanka's tourism industry increasingly undermined by violence related to the ethnic conflict, potential investors are unlikely to see near-term growth potential for Sri Lankan. Most significantly, the Emirates departure demonstrates that the Rajapaksa government is steadily turning Sri Lanka from one of South Asia's most attractive investment destinations to one of its least by breaching contracts, imposing high taxes, arbitrarily changing and applying regulations, and, in cases like this, interfering in business operations.
BLAKE